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Statement by the EC, ECB, and IMF on the Fifth Review Mission to Portugal

Staff teams from the European Commission (EC), European Central Bank (ECB), and International Monetary Fund (IMF) visited Lisbon during August 28-September 11 for the fifth quarterly review of Portugal's economic programme.

The programme remains broadly on track. In 2012, despite headwinds from abroad, real GDP growth remains in line with projections, exports are performing better than expected, and the fast reduction in the external deficit is contributing to alleviating the external financing constraint. Nevertheless, higher unemployment, lower disposable incomes, and a shift in tax bases away from more highly-taxed activities are weighing on revenue collection. Against this backdrop, policy choices need to strike a balance between advancing the required fiscal adjustment and avoiding undue strains on the economy. Swift progress on structural reforms remains key to put the economy on a sustainable growth path. Maintaining broad political and social support for the revised adjustment programme will also be important.

Growth will remain weak into 2013. In 2012, economic activity is projected to decline by 3 percent. Reflecting weaker import growth in euro area trading partners and additional budget consolidation measures, GDP growth is now expected to turn positive only in the second quarter of next year, resulting in a projected GDP decline by 1 percent for the year as a whole.

The fiscal deficit path has been adjusted, particularly for 2013. While spending in 2012 performs somewhat better than budgeted, revenues are lagging significantly behind budget plans. To allow partial operation of automatic fiscal stabilisers, the deficit targets were revised upward to 5 percent of GDP in 2012 and from 3 percent to 4.5 percent in 2013. The 2014 deficit target, at 2.5 per cent of GDP, remains below the threshold of the Stability and Growth Pact of 3 percent. This revised path will allow the government to design and implement structurally sound fiscal measures, while easing the short-term economic and social cost of fiscal adjustment.

But reaching the new deficit targets will require additional consolidation efforts. Agreement was reached on a range of permanent spending and revenue measures to underpin the deficit target in 2013, which also make up for the one-off measures in 2012. Continued efforts to strengthen public financial management, bolster tax compliance, reduce losses of state enterprises, bring down the costs of public-private partnerships, and streamline public administration will also contribute to the needed fiscal adjustment. As part of the measures to compensate for the Constitutional Court decision on the public wage and pension cuts, the government also plans to lower employers' social security contributions, a measure that will improve competitiveness and support employment. Steps will be taken to soften the adverse impact on low-income workers.

Financial stability risks remain well managed. The recapitalisation of the banking sector and the strengthening of banking supervision and resolution frameworks are well advanced. Liquidity in the banking system continues to benefit from exceptional support from the Eurosystem. Deleveraging in the banking system has proceeded on pace, although access to credit at reasonable conditions remains difficult for parts of the economy. A number of policy measures are being prepared with a view to ensuring that viable companies, particularly in the tradable sectors, can adequately fund their activities.

Reforms to raise competitiveness, employment, and potential growth are also progressing. While the revised Labour Code entered into force in August this year, some further important reforms remain to be implemented to create a better functioning labour market. Active labour market policies are addressing the immediate challenges of high unemployment. The privatisation of the national air carrier and the airport concession are under preparation, and ports are becoming more competitive. Further reform steps are on their way, including a sweeping overhaul of licensing, to increase competition, strengthen the business environment, and improve efficiency and reduce rents in the services and network industries. The judiciary reforms in the areas of civil procedure and court organisation, which will speed up civil and commercial litigation and unclog the court system, are progressing well.

Overall, this review confirms that the programme is making progress, albeit against strong headwinds. The public debt-to-GDP ratio will peak below 124%, remains sustainable and will be on a firm downward trajectory after 2014. The authorities continue preparing the return to market financing during 2013 and are committed to cover the additional financing needs arising from the revised consolidation path. Provided the authorities persevere with strict programme implementation, euro area member states have declared they stand ready to support Portugal until full market access is regained.

The government's programme is supported by loans from the European Union amounting to €52 billion and a €26 billion Extended Fund Facility with the IMF. Approval of the conclusion of this review will allow the disbursement of €4.3 billion (€2.8 billion by the EU, and €1.5 billion by the IMF). These disbursements could take place in October subject to the approval of the IMF Executive Board and ECOFIN and EUROGROUP. The joint mission for the next programme review is expected to take place in November 2012.